Fiscal Frameworks for Resource-Rich Developing Countries

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I. MOTIVATION

- Resource wealth: opportunity to boost development...
- But historical record unimpressive.
- Fund’s previous approach:
  - Excessive reliance on Permanent Income Hypothesis (PIH).
- Key innovations:
  - More attention to country-specific factors.
  - Focus on flexibility and trade-offs.
  - Toolkit to help design fiscal rules.
II. ANALYTICAL CONSIDERATIONS

• Traits of natural resource revenues:
  – Exhaustibility.
  – Volatility.

• RRDCs’ distinct characteristics:
  – Low per capita income; limited access to international capital; domestic capital scarcity.

• Capacity constraints have implications for:
  – Speed of scaling up.
  – Design of fiscal rules/savings institutions.
III. FISCAL FRAMEWORK OBJECTIVES

• Fiscal framework needs to address:
  – Demand management.
  – Inter-temporal solvency.

• Additional complications: price volatility and exhaustibility challenges.

• Fiscal institutions: should ensure efficient and transparent use of resource wealth.
IV. FIVE KEY ISSUES

A. Resource Horizon
B. Volatility
C. Sustainability
D. Effective Investment and Resources
E. Natural Resource Funds
A. Resource Horizon (RH)

- Affects choice of fiscal rule.

- Long RH: main focus is managing volatility.
  - Price smoothing rule particularly useful.

- Short RH: give prominence to exhaustibility.
B. Managing Volatility: Smoothing Trade-offs

- Structural primary balance rule ("normal revenues").

![Graph showing Oil budget prices under price rules](image)

Sources: IMF staff calculations.
Managing Volatility: Smoothing Trade-offs

- Structural primary balance rule (computes “normal resource revenues”).

- Provides a simplified way of obtaining “structural” or “normal” resource revenues.

- Spending will be a function of the “structural” resource revenues and the PBs target.

\[ PE = RRs + NRR - PBs \]
Managing Volatility: Smoothing Trade-offs

- Price smoothing rule.

**Real primary expenditure growth**
(Percent change, year-on-year)

Sources: IMF staff calculations.
Managing Volatility: Smoothing Trade-offs

Real primary expenditure growth
(Percent change, year-on-year)

Sources: IMF staff calculations.
Managing Volatility: Saving Trade-offs

Cumulative financial savings
(Percent non-resource GDP)

Sources: IMF staff calculations.
Managing Volatility: Incorporating Prudence

- Smoothing rule can address sustainability concerns (e.g. Chile).

**Savings under 5/0/0 rule and alternative primary balance targets**
(Percent non-resource GDP)

Sources: IMF calculations.
C. Assessing Sustainability

• Compute PIH benchmark.

• Should you deviate from PIH?

• Answer: depends on impact of public investment on growth.
  
  – Deviations could be justified if “resource wealth” is used well (good projects, human capital, etc.).
Assessing Sustainability

Hypothetical fiscal space: PIH
(Percent of non-resource GDP)

Hypothetical fiscal space: FSF
(Percent of non-resource GDP)

Sources: IMF Staff calculations.
D. Critical Factor: Effective Investment

• “Invest” in “public investment process”.
  – Capacity to select, implement and evaluate projects.

• Why? It affects “fiscal returns”.
  – Key to ensure sustainability.

• What else? Track use of resource wealth:
  – Monitor share of public investment in total spending.
E. Resource Funds

• **What purpose?**
  – Save in “good times” and spend in “bad times”.
  – Save for future generations.

• **Source of funding? Fiscal surpluses.**

• **What to avoid?** Independent spending authority.

• **How many?** One fund is easier to handle.
  – Especially when capacity is limited.
  – Separate portfolios for stabilization and saving can be useful.
CONCLUSION

- Conservative approach (e.g. PIH) not optimal.
- Investing part of the resource wealth can be better.
- But need to consider carefully:
  - Absorptive capacity constraints (macro and micro).
  - Political economy: governance and transparency.
- Misuse of resource wealth can be catastrophic:
  - New approach increases the cost of inefficiencies.
  - Scaling up of spending should be gradual, in line with capacity.
# Annex: Fiscal Framework Objectives

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